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**Before the**

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**“Implementing Managerial Cost Accounting Practices”**

Thank you, Mr. Chairman.

I appreciate the opportunity to testify before this Subcommittee to discuss the U.S. Department of Labor’s (DOL) implementation of managerial cost accounting.

The availability of timely, accurate, and useful cost information is an essential component of any well-managed, effective organization. Managerial cost accounting provides the means to accumulate, measure, analyze, interpret, and report cost information that is critical to improving the performance of government. This capability provides program managers and decision makers an essential tool for enhancing the performance of their mandated missions while

improving accountability for the resources entrusted to their stewardship. Effective managerial cost accounting practices support both financial integrity and program performance.

A key statutory foundation for managerial cost accounting is the Chief Financial Officers (CFO) Act of 1990 (P.L. 101-576). The CFO Act requires CFOs to develop and maintain an integrated agency accounting and financial management system. This system must include financial reporting and internal controls that comply with applicable accounting principles. Importantly, the system must provide for the development of cost information and provide for the systematic measure of performance. Subsequently, the Government Performance and Results Act of 1993 (GPRA) (P.L. 103-62) established new performance measurement requirements for program activities, effectively extending the language in the CFO Act concerning the “systematic measurement of performance.”

As part of its mission to develop generally accepted accounting principles for federal financial reporting entities, the Federal Accounting Advisory Standard Board (FASAB) published the Statement of Federal Financial Accounting Standards Number 4 (SFFAS #4) in July 1995. SFFAS #4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*, clearly established the importance of cost information to Congress and federal executives for use “in making decisions about allocating federal resources, authorizing and modifying programs, and evaluating program performance.” SFFAS #4 also recognizes that the discipline of managerial cost accounting can assist agency executives and program managers by enhancing the basis for decisions they make to improve program efficiencies and overall effectiveness. In January 1995, the former Joint Financial Management Improvement Program (JFMIP) issued its *Framework for Federal Financial Management Systems* which emphasized that MCA should be

a fundamental part of a financial management system.

The Federal Financial Management Improvement Act (FFMIA) of 1996 (P.L. 104-208) requires that agencies implement and maintain management systems that substantially comply with federal financial management systems requirements. These requirements are established by the JFMIP Federal Financial Management System Requirements and the Office of Management and Budget's Circular A-127, Financial Management Systems. In February 1998, JFMIP issued two MCA documents: *System Requirements for Managerial Cost Accounting* and *Managerial Cost Accounting Implementation Guide*.

Within this environment, DOL began implementing managerial cost during FY 1999 with agency-specific pilot programs. Initially, DOL planned for the cost models developed in the pilot studies to be aggregated into an integrated agency-wide cost accounting system. However, these first steps produced only isolated successes, which were not generally sustainable and did not gain sufficient managerial acceptance to broaden to other programs. Since these initial efforts were not based on a Department-wide, strategic, and structured approach, they did not garner sufficient executive-level attention and support. Some managers viewed their pilot simply as another accounting exercise to be endured, with a little appreciation for the benefits cost accounting information would provide. By FY 2001, DOL had abandoned this approach. In FY 2002, DOL renewed its managerial cost accounting efforts and began to gain the focus and institutional momentum necessary to sustain effective action. The impetus behind this renewed endeavor came from the President's Management Agenda and audit findings by the Department's own Office of the Inspector General (OIG).

In the summer of 2001, President Bush released his aggressive strategy for improving the management of the Federal government. The President sent the clear message that “good beginnings are not the measure of success. What matters in the end is completion. Performance. Results.” Two of the five initial government-wide initiatives in the President’s Management Agenda (PMA)—improved financial performance and budget and performance integration—need enterprise-wide implementation of managerial cost accounting for success. Both these initiatives challenge agencies to use high quality, integrated financial and performance information to strengthen control over resources and reinforce measurable accountability for results by program managers.

The Office of Management and Budget (OMB) established Executive Branch management scorecards to track how well the departments and major agencies are executing the five government-wide management initiatives. By the spring of 2002, DOL had met all criteria for improving financial management except demonstrating that the Department had integrated financial and performance information using managerial cost accounting. More importantly, however, the Department had not shown that integrated financial and performance information is routinely used by program managers to support operational evaluations and day-to-day decision-making.

In the FY 2002 and FY 2003 audits, the Department’s OIG expressed the opinion that DOL was not in compliance with SFFAS #4. The OIG stated that DOL had not succeeded in its efforts to implement a functional managerial cost accounting system which in turn precluded the Department from using managerial cost information for purposes of performance measurement, planning, budgeting and forecasting. DOL differed with the OIG’s conclusions that the

Department's core accounting system was not in substantial compliance with the FFMIA, but DOL did agree that more attention on Managerial Cost Accounting (MCA) implementation was warranted. In September 2002, DOL's Deputy Secretary had already conveyed to Departmental agency heads the importance of moving forward on a Department MCA program. The Deputy Secretary emphasized to senior management how improved cost information would assist in measuring performance, reducing and controlling program costs, making decisions about modifying or discontinuing program initiatives, and making other important programmatic decisions. This "top down" approach breathed new life into the Department's managerial cost accounting efforts and received strong support from the Department's individual agency heads. DOL was ready to take a more strategic approach to integrating cost and performance information.

In May 2003, DOL's Office of the Chief Financial Officer (OCFO) issued a comprehensive managerial cost accounting plan of action. The plan of action followed an intense reassessment of previous MCA implementation efforts and led to a new implementation strategy. As part of this process, OCFO's MCA Project Management Office (PMO) surveyed and interviewed DOL agency heads, financial managers, and administrative officers of all DOL agencies. Through this process, OCFO sought to better define a Departmental focus for MCA, paying particular attention to guiding principles and criteria by which to measure success. While important consideration was given to department-level strategic needs, agency-specific needs were the primary considerations. Obtaining support from agency heads for the renewed MCA initiative and OIG concurrence with the approach were top priorities in developing the plan of action.

The plan defined roles and responsibilities to implement and sustain MCA in DOL and included

an implementation timeline with key milestones for each agency. Rather than relying on well-intended, but programmatically isolated pilots, this approach targeted a concurrent Department-wide implementation of MCA with support from top management. Early on, the new program gained the acronym CAM for “cost analysis manager.”

Several key principles have been behind the success of the CAM initiative at DOL. First, we have sought to implement a flexible, scaleable MCA capability that leverages what has already been done in DOL’s agencies. DOL has a diverse set of programs ranging from occupational safety and health to pension protections. In addition, some agencies, by virtue of their size, scope, nationwide presence, and prior MCA experience, required detailed cost information by region and on a monthly or quarterly basis to fulfill their management needs. Other agencies only needed annual cost information. We sought to avoid the pitfall of over-standardization; managers won’t use irrelevant information.

We began with a “keep it simple” approach starting with straightforward cost models, but allowing for increased complexity and other “bells and whistles” over time. We wanted to extend MCA capability to each agency within a two-year period, at which time managers would begin to use cost information to support decision making on a routine basis. To avoid overreaching our available resources during the initial implementation phase, we tailored implementation to each agency to provide actionable information that could be incorporated into regular decision making and sustained over time.

During FY 2003 and FY 2004, OCFO’s MCA PMO worked with agencies to develop 18 cost models for 15 agencies. Cost models address the broad spectrum of the Department’s key

business areas: income maintenance; employment and training; labor, employment and pension standards; worker safety and health; and statistics. They help managers assess the reasons for differences in costs of inspections across the country and variances in the cost of providing benefits to recipients from region to region. In the course of developing cost models, the OCFO team worked with CAM implementers from each agency to brief their agency heads on how the cost models were structured and the progress being made on their implementation. Each agency also established its own internal CAM team.

To communicate progress, ideas, and concerns, the OCFO initiated periodic DOL CAM user group meetings. The CAM user group meetings build a collective experience knowledge base and keep agencies advised on CAM development. These meetings serve as a venue to give agency program managers a better feel for the capabilities of managerial cost accounting and as a constant communication forum for agencies to share best practices and lessons learned. At these user group meetings, agencies also report on their CAM implementation progress.

DOL's CAM system went live on September 30, 2004. CAM reports provide managers at all levels with cost information to support program evaluation, decision making, and cost effectiveness in delivery of programs and attainment of goals. As DOL's program managers have found value in cost information and grown comfortable in its use, they are beginning to use the CAM system for budget formulation and justification, resource allocation, and determining "best practices" across similar programs or regions. DOL has also shared best practices from the CAM program with other federal agencies seeking to improve their managerial cost accounting expertise. These best practices include the need for senior management commitment and involvement from the start and ensuring that the MCA system is designed to provide useful

information that addresses major business issues. The MCA system must also meet an agency's cost information requirements to meet its strategic plan, PMA, and PART objectives. Getting participation from managers from all areas of an organization and providing training as an awareness and change management tool are also vital to the success of MCA implementation.

Beyond finding the right methodology to implement managerial cost accounting at DOL, two key factors have made the ongoing success of the CAM initiative possible. First, from a leadership perspective, Department of Labor Secretary Elaine L. Chao has a deep appreciation for effective financial management and sound fiscal integrity. Her understanding and support of managerial cost accounting has been crucial to our efforts to make MCA a lasting legacy that will benefit the Department and American taxpayers for years to come.

Second, DOL has had an enterprise-wide, core financial system since 1989. Over the years, this central system has made possible the delivery of timely and accurate financial information across the Department. External validation of this sound accounting is evidenced by eight consecutive clean audit opinions on the Department's financial statements. Although this system has well served the Department's accounting needs, it does not meet our needs for a financial management information system that provides readily available, transparent data to managers and decision makers for use on a day-to-day basis. We are in the midst of a multi-year project to replace it with a new commercial-off-the-shelf (COTS) system.

As the technical capabilities of DOL's CAM system continue to evolve and as the Department's managerial expertise with cost and performance integration matures, the information generated through managerial cost accounting will become an essential part of program evaluation,



decision-making, and cost effectiveness in the delivery of programs and the attainment of strategic goals. Executives and managers of regional and national programs will be able to make decisions regarding resource allocation for activities that align with and lead to achievement of performance goals by comparing costs of activities and outputs across the district offices, analyzing causes for differences in unit costs of providing services across regions, and identifying best practices and transplanting them across all district offices to achieve desired program results.

In the near term, DOL expects CAM to drive tangible cost and performance enhancements in the Department in several areas:

1. **Improved Cost Management** — Integrating cost information with program performance measures provides insight into the cost-effectiveness of programs and accountability to Congress and the public. Cost information relating to program activities and outputs enables managers to manage costs by identifying high cost activities and redirecting scarce resources from inefficient to cost-effective work processes. CAM can also aid management in identifying and managing these cost differences to improve program performance. By determining the full cost of outputs based on annual and multi-year strategic performance goals, CAM can assist managers' to allocate resources to the highest priority initiatives. For example, several DOL agencies (Mine Safety and Health Administration, Occupational Safety and Health Administration, and Employee Benefits Security Administration) now have cost information on the cost per case or investigation by region or district. Analyzing cost differences among the regions or districts provides insight that helps to identify and manage these cost differences, ultimately improving

program performance. CAM provides the full cost of outputs, which in some cases can be aligned with strategic, outcome, and performance goals. This information allows managers to allocate resources to highest priority initiatives. Lastly, cost information can be used to gauge the economic feasibility of competitively sourcing a particular function. For example, the Office of the Inspector General plans to use cost information to assess whether to perform certain audits in-house or to use contractors to conduct those audits.

2. **More Transparent Fee-Setting** — At DOL, managers of the Working Capital Fund will benefit in two ways. First, managers will be able to use cost information to determine more accurate reimbursement levels for Working Capital Fund services provided to other DOL agencies, such as information technology, human resources, and building facilities services. Second, managers will be able to strengthen their supplier-customer relationships by better explaining to their customers the activities performed and the costs incurred in support of such services. Managerial cost accounting can also help to determine fees to be charged to external customers.

3. **Stronger Budget Formulation and Justification** — Some DOL agencies currently use accounting data to develop their annual budgets. Full cost data available through CAM will help DOL improve its budget formulation process by providing cost information on specific programs and outputs that is aligned with agency annual and strategic goals and outcomes. OCFO's MCA PMO is working with DOL's Center for Program Planning and Results to tie CAM to departmental budget and performance integration efforts. Throughout the fiscal year, DOL will be able to assess its performance against the budget by tracking actual costs of outputs and aligned outcomes — thereby integrating budget, financial, and program information.

OCFO's MCA PMO is currently working with agencies to automate the process of data collection for updating cost models. This will reduce the time and effort required to update the cost models and allow users to utilize cost information and focus on analysis. DOL is planning to expand the capability of the CAM COTS software through COTS add-on modules that will provide users with additional capabilities such as "what-if" analysis and activity-based budgeting.

In conclusion, the implementation of managerial cost accounting is a continuous journey of gaining experience rather than a race to a finish line. Success in implementation takes strong, sustained commitment from senior management and the ability to demonstrate to managers that managerial cost accounting is a tool designed to meet their needs and not just another "silver bullet" from central management.

Thank you for your time. I will be happy to answer any of your questions.